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BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR A HEARING TO DETERMINE THE FAIR VALUE OF THE UTILITY PROPERTY OF THE COMPANY FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN THEREON, AND TO APPROVE RATE SCHEDULES DESIGNED TO DEVELOP SUCH RETURN.

Docket No. E-01345A-11-0224

Arizona Corporation Commission
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NOTICE OF FILING

The RESIDENTIAL UTILITY CONSUMER OFFICE ("RUCO") hereby provides notice of filing the Direct Decoupling Testimony of Frank Radigan in the above-referenced matter.

RESPECTFULLY SUBMITTED this 23rd day of November, 2011.

Daniel W. Pozefsky
Chief Counsel

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of the foregoing filed this 23rd day
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ARIZONA PUBLIC SERVICE COMPANY

DOCKET NO. E-01345A-11-0224

BEFORE THE

ARIZONA CORPORATION COMMISSION

ADDITONAL DIRECT TESTIMONY OF

FRANK W. RADIGAN

ON BEHALF OF THE

RESIDENTIAL UTILITY CONSUMER OFFICE

November 23, 2011

TABLE OF CONTENTS

INTRODUCTION..... 2

EXECUTIVE SUMMARY..... 3

PROPOSED EFFICIENCY INFRASTRUCTURE ACCOUNT MECHANISM ("EIA")..... 6

PROBLEMS WITH PROPOSED EIA..... 10

POLICY QUESTIONS ON ENERGY EFFICIENCY RULES AND DECOUPLING..... 11

DECOUPLING EXPERIENCE IN OTHER STATES..... 15

RUCO'S REASONS FOR OPPOSITION TO DECOUPLING AT THIS TIME..... 22

RUCO ALTERNATIVES TO DECOUPLING..... 27

INTRODUCTION

Q. PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS ADDRESS FOR THE RECORD.

A. My name is Frank Radigan. I am a principal in the Hudson River Energy Group, a consulting firm providing services regarding utility industries and specializing in the fields of rates, planning and utility economics. My office address is 237 Schoolhouse Road, Albany, New York 12203.

Q. ARE YOU THE SAME FANK RADIGAN WHO PREVIOUSLY SUBMITTED TESTIMONY IN THIS PROCEEDING?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR ADDITONAL DIRECT TESTIMONY?

A. I will discuss Arizona Public Service Company's ("APS" or the "Company") proposed decoupling mechanism – the "Efficiency and Infrastructure Account Mechanism" (EIA) sponsored by Company Witness Leland Snook. The decoupling mechanism is a full revenue per customer decoupling mechanism which the Company states is the most common decoupling mechanism used around the country (Snook direct at page 4).

EXECUTIVE SUMMARY

Q. PLEASE PROVIDE A SUMMARY OF YOUR TESTIMONY.

A. RUCO believes it is inappropriate to implement a decoupling mechanism during this period of economic uncertainty and financial stress for ratepayers. Experience from across the country has shown that implementation of decoupling during times of economic stress have actually resulted in their subsequent cancellation which therefore results in decoupling as a detriment to energy conservation rather than an assistance. Second, RUCO finds that with all of the adjustor mechanisms being requested in this case, full revenue decoupling is unnecessary. For example, with the Company's proposed EIA and Environmental and Reliability Account ("ERA"), the Company would be allowed to retain all money from customer growth and carrying charges on all generation plant associated with that growth. Third, while RUCO can easily recognize decoupling as a utility benefit, RUCO cannot justify the corresponding and equal ratepayer burden on all customers when a review of customer usage data shows that it is only a few large users that impose an undue burden on the electric system. RUCO believes that the Commission should first strive to establish a rate design which encourages conservation and avoid implementation of a customer-wide full revenue decoupling mechanism.

Q. WHAT DOES RUCO RECOMMEND?

A. RUCO recognizes that the Commission has mandated that APS implement programs to reduce the amount of energy it sells. Since rates are set on a historical test year using historical test year consumption data, RUCO recognizes that reduced sales without adding new customers could play a factor in the erosion of a utility's ROR[1]. For that reason, ***RUCO believes it is appropriate to provide an alternate proposal to assist the utility in maintaining financial health without shifting risk to the ratepayers***. It is with this in mind that RUCO offers its two alternatives to the EIA.

In lieu of a decoupling mechanism, RUCO offers two different alternatives that provide the utility with financial safeguards yet does not shift the utility's business risk on to the ratepayer. First, in his direct testimony Mr. Snook acknowledges that there is a rate design solution that would protect the Company's financial health while at the same time encouraging conservation (Snook direct at page 8). This rate design approach known as Straight Fixed-Variable ("SFV") would resolve the financial disincentive by having all fixed costs of service would be collected through fixed charges and only variable costs of service would be collected through usage charges (Id). This approach would

[1] But RUCO does not agree that a reduction in use per customer consumption is the sole factor – or even the major factor – in the utility's eroded ROR.

require very high basic service charges and he calculates that the basic service charges for residential service would need to be raised to over $90 per month (Id). Mr. Snook then dismisses this option as being burdensome to customers and therefore unworkable (Id).

What Mr. Snook fails to realize is that that a large majority of customers are small users and it is only a few customers that use most of the power. What this means to energy conservation is that the vast majority of customers whose usage is relatively constant is that their ability to conserve is also small and losses through energy conservation is minimal. On the other hand the few large customers can be encouraged to conserve through aggressive rate design – just over 5% of the residential customers use approximately 15% of the energy sold to the whole residential class. Knowledge of these two facts therefore allows the regulator to address the financial disincentive by designing rates that recover most of the fixed cost through a combination of higher basic service charges and slightly higher charges for the first block of power used. A rate design where energy conservation is encouraged can be achieved through aggressive high volumetric charges for large energy use.

The first option, the rate design option, is similar to the proposal RUCO made in the Southwest Gas and recent UNS rate cases where RUCO proposes to move

more of the revenue requirement into the fixed monthly rate to provide enhanced revenue stability to the utility. RUCO's proposal, however, is not a Straight Fixed-Variable rate proposal would not nearly result in the $90 plus fixed service charge that Mr. Snook's talks of.

The second option is to provide the utility with a cost of equity ***premium*** in lieu of decoupling. Arizona, along with many other jurisdictions, has debated whether to reduce the authorized cost of equity if decoupling is approved in recognition of reduced business risk. RUCO argues that an increase in the cost of equity as an alternative to decoupling would follow a similar logic. As an alternative to the EIA, RUCO recommends adding a premium of five (5) basis points to RUCO's recommended ROE of 10.00%, increasing the recommended ROE to 10.05%.

PROPOSED EFFICIENCY INFRASTRUCTURE ACCOUNT MECHANISM

Q. PLEASE DISCUSS THE PROPOSD EFFICIENCY INFRASTRUCTURE ACCOUNT MECHANISM ("EIA").

A. The Efficiency and Infrastructure Account Mechanism is sponsored by Company witness Leland Snook. The decoupling mechanism is a full revenue per customer decoupling mechanism which the Company states is the most common decoupling mechanism used around the country (Snook direct at page 4).

Mr. Snook states that his proposal addresses the need to modernize the Company's rate structure by adopting a mechanism that will, among other things, allow APS to continue to actively promote energy efficiency and distributed energy programs (Snook direct at page 1). This new rate structure Mr. Snook argues will align the Company's and customers' financial interests, resulting in a more reasonable opportunity for the Company to collect its fixed costs of providing service (Id).

Currently, the vast majority of APS's revenues are collected through volumetric kWh energy charges (Snook direct at page 7). Therefore, the more energy a customer conserves or self-produces, the less fixed-cost recovery APS will receive (Id). In essence, with the implementation of EE and DG, the historic volumetric pricing structure deprives APS from having a reasonable opportunity to earn its return authorized by the Commission (Id).

Mr. Snook states that a rate design approach known as Straight Fixed-Variable ("SFV") would resolve the financial disincentive (Snook direct at page 8). In this rate design method, all fixed costs of service would be collected through fixed charges and only variable costs of service would be collected through usage charges (Id). This approach would require very high basic service charges which

would be particularly burdensome for many residential and smaller commercial customers (Id).

In lieu of the SFV approach APS is proposing its EIA, which is a revenue per customer decoupling mechanism consistent with the Commission approved Policy Statement[2] (Snook direct at page 4). Mr. Snook states that this method was the model preferred by the majority[3] of stakeholders who participated in the Commission Decoupling Workshops and is the mechanism most commonly applied in other regulatory jurisdictions (Id).

Mr. Snook argues that a revenue per customer decoupling mechanism is the most appropriate mechanism for the following reasons:

- It modernizes the rate structure and aligns the Company's and customers' interests by updating customer billing determinants annually in a simple and straightforward manner;
- It is the most commonly applied form of decoupling within the electric and gas utility industries;

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[2] Final ACC Policy Statement Regarding Utility Disincentives to Energy Efficiency and Decoupled Rate Structures, Docket Nos. E-000005-08-0314 and G-00000C-08-0314, issued December 29, 2010 (the "Policy Statement").

[3] RUCO did not "prefer" this model to address the disincentive issue.

- It properly removes the link between volumetric sales and revenue collection, thus eliminating the disincentive associated with implementing EE programs and instead allows a utility to willingly engage in and promote EE programs; and
- It allows a utility to collect a greater portion of its authorized fixed cost of service (as determined within a rate case) associated with both existing and future customers regardless of sales levels. (Snook at page 14)

Mr. Snook also states that the Commission's Policy Statement suggests that a revenue per customer decoupling mechanism is suggested as being better suited than other alternative mechanisms to respond to customer growth typically experienced in Arizona. APS agrees with this observation. (Snook direct at page 6)

As to implementation of the EIA, APS proposes to aggregate all of the differences between authorized and actual fixed cost recovery for each customer class included in the adjustor on an annual basis (Snook direct at page 19). This total amount of over or under-recovery of fixed costs will then be allocated to each eligible customer class on an equal percentage basis (Id). In recognition of the fact that not all classes are homogenous APS has included all customer classes in the EIA mechanism, except for the following rate schedules: E-30, E-36 XL, E-

47, E-58, E-59 and Contract 12. (Snook direct at page 16). Mr. Snook states that the annual reconciliation and exemption of some customer classes are consistent with the (Snook at page 19).

PROBLEMS WITH PROPOSED EIA

Q. DO YOU SEE ANY PROBLEMS WITH THE PROPSOED EIA?

A. Yes. First and foremost, RUCO recognizes that ratepayers prefer not to see too many surcharges on their bills. That observation applies to electric bills, bank statements, credit card bills or cable company bills. Thus, any and all means of avoiding an automatic adjustor mechanism should be examined first.

Second, the Company is simply wrong that its EIA is better suited to respond to growth typically experienced in Arizona. By this the Company means that under its proposed EIA it is allowed to keep any revenue from the growth in the number of customers between rate cases. The idea behind this approach is that the Company must invest in new distribution and generation facilities to serve customers. In this case, however, with the new Schedule 3, the Company's outlay for new distribution facilities will be reduced. Further, the Company is asking for a return on 18 months of post test year pant additions and is requesting any carrying charges for new generating plant be recovered via the ERA.

Third, the Company's rate design proposals are at odds with it statements that it wants to encourage energy conservation. For Residential Service Class E-12 the non time-of-use class, the Company is proposing a 36% increase in the basic service charge and a 3%-6% decrease in energy charges (See SFR Schedule H-3). For the largest residential time-of-use class the Company is proposing a 4% increase in the basic service charge, a 14% increase in the off-peak energy charge and an 8% decrease in the on-peak energy charge (Id). This type of rate design helps the Company recover more fixed charges and makes energy conservation less attractive as it reduces the savings from any energy conservation project. Thus, while APS states it does not want a straight fixed variable rate design to protect its fixed costs recovery it gets exactly that in its proposed decoupling rate design. Thus, the Company's preferred rate design makes the EIA superfluous and acts as suspenders to the rate design belt.

POLICY QUESTIONS ON ENERGY EFFICIENCY RULES AND DECOUPLING

Q. DOES RUCO SUPPORT THE ACC'S ENERGY EFFICIENCY RULES?

A. Yes.

Q. DID THE COMMISSION PROMULGATE ITS ENERGY EFFICIENCY STANDARD CONTEMPORANEOUSLY WITH ITS ADOPTION OF ITS POLICY STATEMENT FAVORING DECOUPLING?

A. No. The Commission adopted its EE Rules before it approved its Decoupling Policy Statement. The Commission approved its Energy Efficiency Rules for electric on July 27, 2010 and approved its Policy Statement on decoupling on December 14, 2010.

Q. WHY IS THAT IMPORTANT?

A. The utilities supported and committed themselves to the EE Standard without any certainty that the Commission would take any favorable position on decoupling.

Q. DOES RUCO OPPOSE A DECOUPLING MECHANISM IN PRINCIPLE?

A. No. However, RUCO continues to have concerns about whether decoupling will achieve its intended objective of encouraging reduced consumption of electricity. And at this time, in this case, given current economic conditions and current ratepayer opposition, RUCO does not find authorization of the EIA for APS to be in the ratepayers' best interest. Nonetheless, that does not mean RUCO is unalterably opposed to decoupling.

Q. DOES A DECOUPLING MECHANISM IMPROVE THE FINANCIAL POSITION OF A UTILITY?

A. Yes. A utility with healthy credit metrics can attract investors and can obtain debt at low interest rates. The utility passes these benefits to the ratepayers through lower rates. Therefore, there may be a time when an asymmetrical, risk shifting ratemaking mechanism, such as decoupling is acceptable. But now is not the time.

It can be argued that a more appropriate time to shift business risk to ratepayer from the utility is when the economy is robust, when unemployment is low, when real estate occupancy is high and the benefit of attracting investors with more than traditional regulatory environment outweighs the additional burden on ratepayers.

Optimally, a decoupling mechanism would provide equal benefits to both the ratepayer and the utility. RUCO believes it is in the interests of consumers to delay building additional infrastructure because the costs of new infrastructure would most likely raise rates higher than the adjustments made through a decoupling mechanism. With decoupling, consumers would pay a little more now (in order to cover the utility's business risk of reduced sales) so as to avoid paying a lot more later for the cost recovery of new plant and infrastructure.

Q. HAS APS PUT ANY EVIDENCE INTO THE RECORD THAT IT WILL NOT ADVANCE IN GOOD FAITH DSM AND ENERGY EFFICIENCY PROGRAMS TO MEET THE COMMISSION'S EE GOALS UNLESS IT IS GRANTED THE EIA?

A. No.

Q. WOULD RUCO EVER SUPPORT A DECOUPLING MECHANISM?

A. Yes. RUCO is willing to consider the idea that a well constructed, limited and constitutionally sound mechanism that assists the utility in retaining financial health while meeting energy efficiency goals may be in the public interest once the economy recovers.

Q. PLEASE EXPLAIN WHAT YOU MEAN BY CONSTITUIONALLY SOUND?

A. This testimony is intended to provide the policy reasons why RUCO opposes decoupling. RUCO's legal and constitutional considerations were expressed in detail in RUCO's Reply Brief in the Southwest Gas rate case, Docket No. G-01551A-10-0458.[4]

[4] http://www.azruco.gov/swg_(10-0458)/reply_brief.pdf

That said, RUCO understands **Scates**[5] permits adjusters to recover discrete and identifiable ***expenses***. Here, a decoupling "tracker", "rider", "surcharge" or whatever you want to call it allows the utility to recover lost ***revenues***. RUCO is uncertain whether a court would extend **Scates**-approved recovery of expenses outside of a rate case to lost revenues. Revenues are calculated as part of the utility's authorized operating income. Operating income is calculated by applying the fair value rate or return to the fair value of the utility's assets. Operating income plus operating expenses yields the overall revenue requirement. The second legal concern RUCO posited in Southwest Gas is that RUCO is concerned that a broad revenue decoupling mechanism could enable a utility to overearn and to charge rates that are no longer just and reasonable based on the fair value of the utility's assets determined during the rate case.

DECOUPLING EXPERIENCE IN OTHER STATES

Q. HAVE OTHER JURISDICTIONS CONSIDERED DECOUPLING?

A. Decoupling has had a varied past. States like Washington, Maine and New York adopted decoupling and then dropped it. Maine pioneered a fully decoupled rate design with Central Maine Power in 1991 but faced a recession in the early 1990s. The sudden and sharp downturn in the Maine economy reduced consumption to a

[5] See Scates v. Arizona Corporation Commission, 118 Ariz. 531, 578 P.2d 612 (App. 1 1978)

much greater degree than the utility's efficiency efforts and the recession resulted in lower electricity sales. The Decoupling adjustment resulted in an increase in rates reflecting pre-recession target revenues and the adjustments caused rates to go up. Rather than promoting conservation, decoupling became to be viewed as a mechanism that was shifting the economic impact of the recession from the utility to consumers. By 1993, deferrals accumulated to such a high level that Maine Commission and the utility agreed to end the experiment.

In New York, where I was on the Public Utility Commission's Staff, we were both one of the leading Commissions to first adopt decoupling and one of the first to abandon it after rate shock experiences similar to Maine.

Q. WHAT HAPPENED IN WASHINGTON?

A. In 1995, the Washington Utilities and Transportation Commission (WUTC) decided to terminate its experimental periodic rate adjustment mechanism (PRAM) for Puget Sound Power & Light, Co. The mechanism was designed to remove disincentives to conservation by decoupling revenues from sales levels and allowing dollar-for-dollar recovery of resource-acquisition costs. The WUTC found that in the 5 years of experience with the PRAM, there were increases in rates in every year and the increases resulted from an extraordinary combination of events: 1) the addition of new power sources, 2) extended drought conditions in

the Columbia basin, 3) warmer than average winters, and (4) Puget's initiation of an aggressive conservation program. Under the PRAM's "awkward marriage," the rate impacts of the resource-cost adjustment overwhelmed the rate impacts of the decoupling adjustment, making a fair comparison of decoupling with traditional ratemaking difficult. The WUTC added that neither feature provided a clear incentive for the company to manage its acquisition of supply and demand-side resources at least cost, and that the PRAM shifted some degree of risk from the company to its customers. *Washington Utilities and Transportation Commission v. Puget Sound Power & Light Co.,* Docket No. UE-950618, Sept. 21, 1995 (Wash.U.T.C.).

Q. ARE YOU AWARE THAT THE VIRGINIA CORPORATION COMMISSION HAS APPROVED DECOUPLING MECHANISMS?

A. Yes. After the Virginia General Assembly directed the Virginia State Corporation Commission to implement decoupling, the Commission approved decoupling for three utilities, Virginia Natural Gas, Columbia Gas and Washington Gas Light Company. In its 2010 report to the General Assembly, the Virginia Commission expressed concern that these utilities received revenues from decoupling far in excess of lost revenue associated with reduced natural gas sales.

"To illustrate this point, the current actual results indicate that since its inception, VNG's decoupling mechanism has compensated the company approximately $7.7 million for forecasted energy reductions of approximately 18 million Ccfs.

However, VNG's own estimates indicate that its programs have generated actual reductions of less than 491,000 Ccfs, so consumers are paying for a level of energy reductions that are not occurring."

"The results were similar to Columbia's and WGL's programs. Specifically, Columbia's decoupling mechanism enabled it to collect additional non-gas revenue of nearly $3.2 million based on assumed usage reductions of 8.4 million Ccfs. However, Columbia's engineering estimates indicated that its programs have generated actual reductions of approximately 77,000 Ccfs. WGL's decoupling mechanism enabled it to collect additional non-gas revenue of $219,275 from ratepayers during a period in which WGL had not yet implemented its conservation and energy efficiency programs."[6]

Q. WHAT HAPPENED IN DELAWARE?

A. In 2009, the Delaware General Assembly mandated the Commission authorize revenue decoupled rate designs by the end of 2010. (26 Del. C. §1500(b)(8)) However, during the 2010 legislative session, the General Assembly repealed that mandate. (HB378, Ch. 77:435)[7]

Q. CAN YOU PROVIDE A SUMMARY OF OTHER STATES EXPERIENCE WITH DECOUPLING?

A. Yes, below is a summary of some other States experience.

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[6] http://www.scc.virginia.gov/comm/reports/ngc_rea_09.pdf

[7] http://legis.delaware.gov/LIS/lis145.nsf/vwLegislation/HB+378/$file/legis.html?open

Rhode Island
Narragansett Electric d/b/a National Grid

"Revenue decoupling would protect the Company from revenue declines attributable to any cause, not only energy conservation and efficiency efforts. Decoupling would reduce the company's revenue risk to zero and shift the risk of revenue variations to ratepayers. While the record includes substantial evidence of the benefits of decoupling to the Company the evidence that decoupling will benefit ratepayers is largely speculative. Indeed the record reflects the significant financial impact on ratepayers that decoupling might have. Over the last four years, revenue decoupling would have resulted in an additional $34 million of payments to the Company." (Docket No. 3943, Order at p. 70 dated 1/29/2009)[8]

Nebraska
Aquila

"The revenue normalization adjustment (RNA) is intended to address declining revenues related to decreases in declining usage... Such automatic mechanisms can lead to excessive rates, an inappropriate shifting of risks from stockholders to ratepayers, and decreased incentives to operate efficiently. Therefore, the Commission finds that the rate mechanisms should be denied." (Application No. NG-0041, Order at pp. 20-21 dated 724/2007)[9]

Indiana
Southern Indiana Gas (Vectren)

It would not be equitable to allow Petitioner to recover from its ratepayers for energy savings caused by ratepayers own responsible efforts to conserve...Vectren South's decoupling proposal would allow the Company to recover revenues for reductions in energy consumption that were not caused by its conservation efforts. Vectren South's proposal is for "full" decoupling, which means that it will recover its lost margin regardless of causation." (289 PUR 4th 9, 2011 WL 1690057, April 27, 2011, Order at pp. 85-86)[10]

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[8] http://www.ripuc.org/eventsactions/docket/3943-NGrid-Ord19563(1-29-09).pdf

[9] http://www.psc.state.ne.us/home/NPSC/natgas/orders_natgas/pdf_orders_natgas/NG0041070724.pdf

[10] http://www.in.gov/iurc/files/Cause_No._43839.pdf

Montana
NorthWestern Energy

After originally approving decoupling for electricity with a reduced ROE but denying decoupling for natural gas in 2009, the Commission eliminated decoupling for NorthWestern's electric utility without any change to its previously approved reduced ROE. (Docket No. D2009.0.129 / Order No. 7046i, June 30, 2011, Order at p. 58)[11]

Tennessee
Piedmont Natural Gas

Had the mechanism been in place since Piedmont's last rate case in 2003, Piedmont's revenues would have grown by $19 million. "The panel found that Piedmont failed to present sufficient evidence to justify a need for a new financial incentive in order to comply with state and federal law regarding conservation while earning a just and reasonable rate of return. The Authority must be able to determine the benefit to consumers before permitting Piedmont an additional financial incentive." (Docket No. 09-00104, June 9, 2010, Order at pp. 5, 12)[12]

Connecticut
Yankee Gas Company

Yankee did not propose a decoupling mechanism because of recent Department Decisions. Yankee contended that it has satisfied the decoupling requirement stated in Conn. Gen. Stat. 16-19tt through its proposed rate design. More specifically, proposed rates in both RY1 and RY2 exhibit a slight increase in fixed cost recovery. (Docket No. 10-12-02, June 29, 2011, Order at p. 168)[13]

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[11] http://psc.mt.gov/Docs/ElectronicDocuments/pdfFiles/D2009-9-129_7046i.pdf

[12] http://www.state.tn.us/tra/orders/2009/0900104cg.pdf

[13] http://nuwnotes1.nu.com/apps/financial/nuinvest.nsf/0/552D929F0B8C6FB2852578BF004639C5/$FILE/Yankee%20Gas%202011%20final%20rate%20decision.doc

Connecticut Light and Power

The AG, Wal-Mart, the Connecticut Industrial Energy Consumers (CIEC) and the Office of Consumer Counsel (OCC) all opposed decoupling. Wal-Mart found decoupling would result in rate changes that are inversely proportional to customer efficiency efforts so as customers implement more energy efficiency, the rate increases. Plus, decoupling sends counterintuitive price signals through increased rates even through substantial efforts were undertaken to reduce energy consumption. "Based on the evidence in this proceeding, the Department finds that it is reasonable to maintain decoupling for CL&P through rate design. Therefore, CL&P's proposal is denied." (Docket No. 09-12-05, June 30, 2010, Order at pp. 165-174)[14]

Connecticut Natural Gas

"The Department agrees with the OCC and AG" that decoupling shifts business risk from the utility to customers and that decoupling actually creates a disincentive for customers to pursue conservation and load management programs by denying the full bill reduction benefits of their conservation efforts. (Docket No. 08-12-06, June 30, 2009, Order at pp. 75)[15]

Q DOES EVERY UTILITY ENDORSE DECOUPLING?

A. No. Southern Company is the parent company for Georgia Power, Mississippi Power, Alabama Power and Gulf Power. It has 4.4 million customers in four states. In its second quarter 2009 earnings call, Southern Company's Chairman, President and CEO, David Ratcliff stated:

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14 http://www.dpuc.state.ct.us/dockhist.nsf/8e6fc37a54110e3e852576190052b64d/08d20a020e13c584852577b6005de25b/$FILE/091205-063010.doc

15 http://www.dpuc.state.ct.us/dockhist.nsf/8e6fc37a54110e3e852576190052b64d/8686a942e1915128852576 5b004bbd27/$FILE/081206-063009.doc

"But fundamentally, we don't think that the decoupling concept works in our regulatory environment. And fundamentally, I've said I don't particularly like the notion. I think there is good reason to keep the cost of the product connected with the use of the product and make sure that our customers are as informed as we can possibly make them about how to use a product and the service efficiently and effectively to control their costs. I like that model a lot better than I like disconnecting what I thought ought to go together."[16]

Q. SO WHAT DOES RUCO WANT THE COMMISSION TO LEARN FROM THIS REVIEW OF DECOUPLING IN OTHER STATES?

A. This review shows that "decoupling fever" is not an epidemic nor is it a be all and cure all to encourage energy efficiency. Several other jurisdictions have rejected decoupling for the very reasons that RUCO opposes it in this docket. Furthermore, states that have at one time embraced decoupling have now distanced themselves from it. (Maine, Montana, Delaware and Virginia).

RUCO'S REASON FOR OPPOSITION TO DECOUPLNG AT THIS TIME

Q. WHAT IS THE MAIN REASON THAT RUCO OPPOSES DECOUPLING AT THIS TIME?

A. As RUCO has articulated in the recent Southwest Gas and UNS Gas cases, it is because decoupling shifts risk of Arizona's poor economy, with its slew of vacant housing and closed businesses for the utility to ratepayers. Another way to say it

[16] http://seekingalpha.com/article/152321-southern-company-q2-2009-earnings-call-transcript?part=qanda

is that decoupling recession proofs the utility. Decoupling also takes other risks away from the utility such as lost sale due to cooler than normal weather, storms or as just recently occurred lost sales due to operational error. RUCO believes that there are much better alternatives to encourage conservation without decoupling. Even without ratepayer and utility benefits being on "equal footing", RUCO finds there may be an indirect benefit to ratepayers in that decoupling provides the utility with increased financial stability from reduced business risk and a nearly-guaranteed rate of return. However, when the economy is stalled like it is today, this indirect benefit is not enough for the consumers and RUCO cannot support the EIA. Furthermore, as stated previously, there are other ratemaking alternatives that provide the utility with sound financial metrics without shifting risk to the ratepayers.

Q. PLEASE EXPLAIN.

A. Under a well-constructed decoupling mechanism, the utility would implement robust and cost effective energy efficiency programs and individual ratepayers would use less energy and enjoy reduced monthly bills. Reduced consumption would delay the need to build new and very expensive generation, transmission and other infrastructure. A decoupling mechanism would hold the utility harmless for the lost revenue associated with reduced consumption and allow it to cover its fixed costs. In the end, the added revenue paid by the ratepayers through

the decoupling mechanism would be vastly outweighed by the deferred costs to build new plant and corresponding infrastructure.

Q. WHY ISN'T THAT THE CASE HERE?

A. Aside from the investment in the Az Sun program the vast majority of rate base investment being made by this Company is for distribution related plant. Utilities defer construction of new distribution plant when there are no new customers. No amount of reduced consumption by current ratepayers will defer the need for new distribution infrastructure for new customers. The construction of new infrastructure is based entirely on the need for new distribution service to new customers and not to meet the needs of existing customers.

Q. WHY IS THE STATE OF THE ECONOMY A MAJOR FACTOR IN RUCO'S OPPOSITION TO DECOUPLING IN THIS RATE CASE?

A. RUCO contends that it is not in the public interest to implement decoupling during a time of economic uncertainty and stress.

Arizona families are suffering. Arizona has one of the highest home foreclosure rates in the nation and has the unenviable status of an unemployment rate exceeding the national average. A staggering 20% of Arizona's population lives at or below the poverty level. The percentage of residential ratepayers

participating in CARES is six point three (6.3) percent. Maine's PUC eliminated decoupling after residents voiced their opposition for having to cover the utilities' business risks in the middle of the economic recession of the 1990s. And the same complaints are being expressed to the Commission in the Public Comment meetings for the Southwest Gas and this APS rate case.

As the Commission has heard from retirees in recent public comment sessions, unstable and weak market performance has decimated the value of many retirement investment portfolios. While retirees did everything right to save for their retirement years, the poor economy and the absence of cost of living increases in Social Security, make their financial futures uncertain.

From this perspective, RUCO argues that shifting a utility's business risk on to ratepayers at this time is unfair.

In times such as these, most ratepayers' efforts to reduce their bills have little to do with the commendable goal of preserving our natural resources or limiting future utility infrastructure. Ratepayers need their bills to be as low as possible because they need to shift those savings to other costs – like paying the mortgage or covering increased food costs. This is the type of "shift" the ratepayers are

trying to do. They should not have to share the savings from their efforts with the utility because the utility wants to shift its risk on to them.

In addition to filing testimony in the Southwest Gas case on behalf of Staff, Dr. David E. Dismukes has been an expert witness against decoupling in several other jurisdictions. In Tennessee, Dr. Dismukes provided testimony on why consumption decreases during poor economic times. RUCO agrees with his statement and adopts its spirit as its own:

> "Decreases in sales associated with economic downturns have nothing to do with energy efficiency programs offered by the Company. Instead, they are the natural reaction of households trying to reduce their expenditures during difficult economic times or, alternatively, businesses and industries idling or shutting down their operations. Under revenue decoupling, ratepayers would be required to make a utility whole for revenue losses during these economic downturns, whereas under traditional regulation, utilities bear the risks of these economic contractions, just like many other types of businesses and industries." (Dismukes testimony, p. 65, Chattanooga Gas Company, Docket No. 09-00183)[17]

In Arizona many, many businesses have shut their doors. Commercial real estate vacancy rates are very high. And Arizona's home foreclosure rate is one of the highest in the country. These empty dwellings have contributed to the reduced electric consumption. And economic forecasts do not show significant improvement in the near future. So it is inherently unfair for APS electric

[17] http://www.tn.gov/tra/orders/2009/0900183bs.pdf

customers to pay a decoupling charge that contains the effects of the real estate bust embedded in it. Not only would customers pay for cost effective and successful DSM/EE programs, but they would also be shielding the utility from the impact of shuttered businesses and empty homes.

RUCO ALTERNATIVES TO DECOUPLING

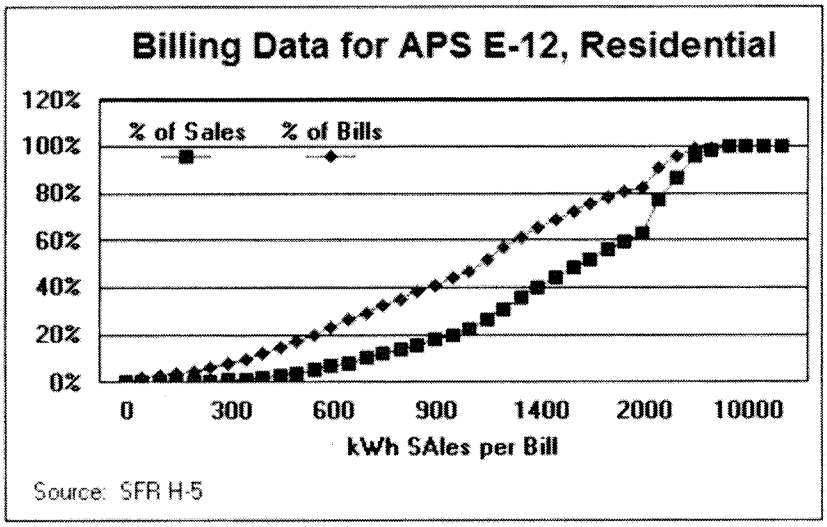
Q. PLEASE SUMMARIZE RUCO'S TWO ALTERNATIVES TO DECOUPLING?

A RUCO provides two options for consideration, a rate design option and a return on equity premium.

Q. PLEASE EXPLAIN THE RATE DESIGN OPTION?

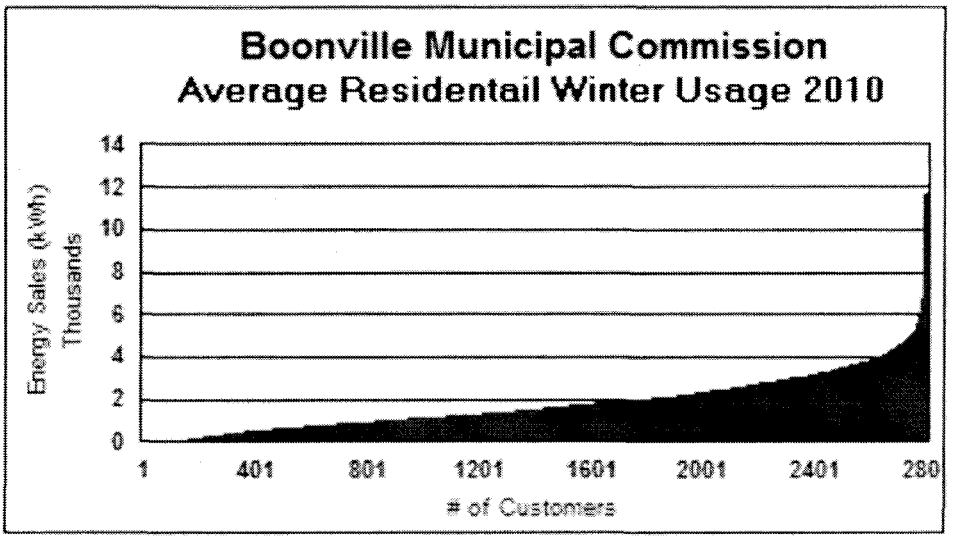
A. The rate design option recognizes that for a large portion of the customers electricity usage is not a true variable that they whimsically use. Rather it is an everyday part of their lives which for the most part they do not try and directly control. For example the refrigerator runs 24 hours a day, the television is watched at night, the clock radio is always plugged in, etc. There are certainly opportunities to shift usage away from the peak period and APS already has approximately 50% of their residential users on time of use rates. While there are opportunities for energy conservation these opportunities are generally one time events, a new more efficient refrigerator is purchased, an electric water heater is

wrapped, etc. These savings generally result in new appliance standards and take place over time. As illustrated by the chart below for the E-12 Residential Class approximately 50% of the bills are for 1,000 kWh or less per month and this 50% accounts for only 22% of total sales. On the other hand, 20% of the bills are for usage above 2,000 kWh per month and they account for 40% of the sales.



This observation tells two things. Most users are relatively small and their usage relatively constant but there are a few large users that use most of the energy. Said another way, even though the rate design recovers costs from both a fixed charge and a variable charge, the revenues received from most bills is relatively constant but there are some large users whose usage will change with weather.

This observation holds true if the utility is a summer peaking utility in the American Southwest or a winter peaking utility in upstate New York. The chart below is a graph of average winter usage for the electric customers of the Boonville Municipal Commission located in Boonville, New York. Located not far from the snow belt of the great lakes, Boonville's nickname is the Snow Capital of the East and is considered a snowmobiling destination. Boonville is located in what is known as the New York "North Country" where winter temperatures reach 25 below zero on a not uncommon basis. Boonville is also one of the 47 municipal utilities in New York State which get the majority of their power from Niagara Power Project located at Niagara Falls. The Niagara Power Project was built in the early 1960s. It has its construction bonds paid off and sells power at costs which is currently about 1.1 cents per kWh... In fiscal year 2010, the Municipal Commission of Boonville sold power at an average retail rate of 4.2 cents per kWh. At rates this low many people use electricity to heat their homes and some user's average over 14,000 kWh per month during the winter period. That said, however, as illustrated by the chart below the usage patterns of the customers of the Boonville Municipal Commission is very similar to the customers of APS; the majority of customers are relatively small users with a discreet few using a large amount of the energy.



The RUCO rate design option takes advantage of the fact that most users are small and the vast amount of revenues collected by the utility are from these small users. This allows the rate designer to place more revenue into the fixed monthly minimum and lower usage rate blocks and provides a more stable and assured revenue stream for the utility. At the same time, one can increase the tail block rate and encourage large users to conserve. Thus, regardless of its DSM/EE efforts, APS will continue to collect a larger portion of its revenue requirement in its monthly minimum. RUCO notes that this Commission has approved shifting more revenue into the fixed charge as an acceptable method of addressing lost revenue due to reduced consumption in the previous Southwest Gas (Decision No. 70665) and UNS Gas (Decision No. 71623) rate cases. RUCO proposal is consistent with past Commission decisions.

While RUCO is still in the process of finalizing its rate design testimony and rate design to be filed on December 2, 2011, the table below illustrates the rate design concept outlined above for E-12, the Residential non-time of use service class. This rate design was developed based on the assumption that the RUCO recommended no net rate change proposal would be adopted in this case and that any rate design developed would need to be revenues neutral.

Bundled Rates	Present	RUCO Proposed	% Change
Summer			
Days $/day	$ 0.285	$ 0.299	5.00%
First 400 kWh	$ 0.09671	$ 0.09574	-1.00%
Next 400 kWh	$ 0.13739	$ 0.13602	-1.00%
Next 2200 kWh	$ 0.16281	$ 0.16118	-1.00%
Remaining kWh	$ 0.17358	$ 0.20520	18.22%
Winter			
Days $/day	$ 0.285	$ 0.299	5.00%
All kWh	$ 0.09397	$ 0.09303	-1.00%

As can be seen from this table, there is a small increase in the basic service charge which has effect of increasing it form $8.64 per month to $9.05 per month but a large increase in the tail block rate.

Q. PLEASE EXPLAIN RUCO'S OTHER ALTERNATIVE – PROVIDING A COST OF EQUITY "PREMIUM".

A. Many states have debated whether to lower a utility's authorized cost of equity in recognition of reduced business risk associated with a decoupling mechanism. The argument is that since decoupling shifts risk away from the utility and onto the customer, that reduction in risk should be reflected in the utility's authorized cost of equity. For example, in Nevada, Southwest Gas admitted that a decoupling mechanism reduces risk and the Commission reduced its authorized return on equity by 25 basis points. (Docket No. 09-04003, Order at p. 15)

Q. WHY IS A FIVE (5) BASIS POINT INCREASE AN APPROPRIATE INCREASE?

A. RUCO has reviewed Orders in other jurisdictions that have decreased the authorized cost of equity to adjust for decreased risk from decoupling. RUCO finds there is an arguable correlation between the amount of reduction taken in consideration of decoupling and a risk premium absent decoupling. In Southwest Gas's recent Nevada rate case, it argued that a 10 basis point adjustment to reduce risk was appropriate:

"Southwest provided the results of a survey of 26 gas decoupling programs and how regulatory agencies have treated ROE in the context of reduced risk…Every state commission that has considered the risk implications of revenue decoupling concluded that decoupling reduces risk. ROE reductions that have accompanied decoupling range from 0 basis point to 25 basis points with a simple average

reduction of 12.5 basis points…Southwest acknowledged that while decoupling does reduce risk, there is no way to empirically quantify its effect." (Order in Docket No. 09-04003, pp. 10-11)

Q. BUT DOESN'T ARIZONA'S POLICY STATEMENT STATE THAT A COST OF CAPITAL ANALYSIS SHOULD NOT CONSIDER REDUCED RISK IF DECOUPLING IS IMPLEMENTED?

A. Yes, and so does APS in its application. So arguably if there is no need to reduce the ROE when approving decoupling, then there is no need to increase the ROE when denying decoupling. However, RUCO does believe that its proposal to include an ROE premium is reasonable and helps the utility attract investors and maintain healthy financial metrics while implementing cost effective energy efficiency programs.

Q. DOES THAT CONCLUDE YOUR ADDITIONAL DIRECT TESTIMONY?

A. Yes it does.